Real People Kenya Limited

REAL PEOPLE™

Financial results for the year ended 31 March 2016

Contents

1. Introduction 3
2. Overview: Operating environment 3
3. Regulatory developments 4
4. Capital 4
5. Funding and liquidity 4
6. Business Prospects 5
7. Financial Results 6
8. Credit Quality 9

1. Introduction

In the twelve months to March 2016, the business maintained its strategic focus of lending to its chosen target segment of micro and small enterprises. This segment remains a significant contributor to the economy and has shown strong resilience and growth over the period. However, following adverse market and macroeconomic conditions particularly in the second half of the financial year, significant strain on the ability of the target segment to service its credit facilities was experienced.

As a result, the business experienced a slowdown in loan origination volumes in the period from Oct 2016 to March 2016. Asset growth over the year was thus behind the forecast indicated in the bond investment memorandum (IM) by approximately 16%. The closing of the first tranche of our bond program in August 2015, enabled Real People Kenya to be better positioned for quality balance sheet growth while at the same time reducing the potential volatility of forex movements on our financial results. That asset growth trajectory has however been slower than anticipated as enumerated above.

The volatility in macroeconomic conditions saw a general rise in non-performing loans across the industry in H2 of the year. Real People Kenya was also affected as our customers endured the market uncertainties. Further, as at March 2016, a revision to the estimates used under our provisioning methodology was applied retrospectively to the full year which resulted in a once-off additional impairment of KES 185m over and above the 10% rise in normalised impairments.

While the quality of the General Purpose Facility (GPF) book was more stable, the performance of our Productive Asset Loan (PAL) product deteriorated. We have since suspended origination of the PAL product and are in the process of revamping it, with a view to relaunch in September 2016. We have emphasised the continuous improvement of the quality of the book as a key priority, which will ensure stable asset performance and improved profitability.

Compared to the cost forecasts in the bond IM, the operating expenditure over the year was higher by 8%, mainly attributable to increased amortisation of costs related to the upgraded origination and credit assessment technology (Project Victoria) and a marginal increase in staff and premises costs.

Despite some erosion in the capital base arising mainly from the impact of the once-off impairment, the business remains solidly capitalised (capital ratio of 30.7%) above the covenanted levels.

We view human capital as our most critical resource and, accordingly, have further strengthened this resource by ensuring that the skills we have on board are able to deliver the strategic challenge we have set for ourselves.

To further strengthen the overall governance and support our continued efforts to responsibly grow this business, the board appointed in the last quarter a new Board Chairman with local experience, Mr Albert Ruturi, former CEO of KRep Bank. The board also approved a change in auditors from PKF to Grant Thornton during this period in line with the appointment of Grant Thornton as Group auditors in 2015.

2. Overview: Operating environment

Kenya's GDP grew by 5.6% in 2015 compared to 5.3% in 2014. This was below the government target of at least 8%. The growth in 2015 was driven mainly by agriculture, manufacturing, real estate, ICT and financial services. Tourism slowed down significantly. The expected growth rate for 2016 is 6.8%.

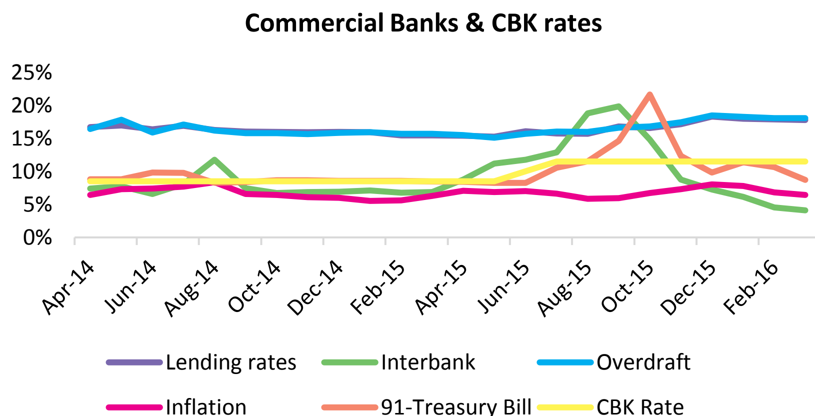
In the twelve months to March 2015, inflation was in the 5.5% - 8% range, in line with the Treasury's medium term target of a maximum of 7.5% although it surpassed 8% December 2015 owing to the introduction of new excise taxes.

The July – Nov 2015 period saw significant volatility in interest rates in the market as commercial banks raised their loan rates to highs of 24+% following huge spikes in the treasury bill rates. Despite the volatility, we took a longer-term view and did not revise our lending rates. As at end March 2016 and following sustained pressure from CBK, and reduced/ diversified borrowing by Government, the Treasury bill (91 day) rates settled at about 8.7% from a high of 24% in October 2015. We expect that CBK will continue to focus on containing inflation and price stability in the next twelve months.

The Kenya Shilling hit an all-time high of KES 106 to the USD in September 2015 and has seen a 6% overall depreciation over the last twelve months. However, it seems to have stabilised at around KES 100 to the US dollar in the last quarter.

The challenges faced in the financial sector that led to the collapse of Dubai and Imperial bank, the subsequent closure of Chase Bank, concerns at NBK and the tighter regulatory oversight by CBK has kept everyone keenly watching the developments in the sector. The industry reported a significant rise in non-performing loans in the second half of 2015. As a result of this and other factors, private sector credit to our target segment grew at a lower than expected rate, aggravated by base lending rate increases by the CBK (intended to cushion the Kenya Shilling exchange rate from entering into free fall).

However, we foresee that in this FY2017, the micro and SME segment will continue to be the significant driver of the economy and lead in the creation of jobs.



3. Regulatory developments

The Companies Act of 2015 and the Insolvency Act of 2015, which were signed into law have outlined some additional regulatory and governance requirements that we are confident we are capable of meeting. The Financial Services Authority Bill of 2016 is at draft form and is likely to be tabled in Parliament in August 2016. In essence the bill seeks to put in place a regulatory framework for credit only institutions, where Real People Kenya currently falls. We are closely engaged in the debates on the bill and are watching the developments very closely.

Cognisance has also been taken of the significant emphasis by the CBK of the financial sector's need to lower the overall cost of credit and we expect this focus to continue over the foreseeable future.

4. Capital

Real People covenants to maintain a minimum capital level for the protection of senior funders of 20% of qualifying capital to total assets, where qualifying capital includes ordinary shareholder's equity, subordinated debt and preference shares.

The business remains adequately capitalised at 30.7%, above the covenanted level. The reduction in the capital ratio year on year is due:

- to the increase in total assets resulting from the bond proceeds.
- Reduction in the retained earnings as a result of the losses sustained during the financial year.

KES million	Mar-15	Mar-16
Qualifying Capital	991	898
Total Assets	2,125	2,927
Capital Ratio	**46.6%**	**30.7%**

5. Funding and liquidity

5.1. Funding

The company is funded through a mix of local currency long-term debt raised from the local capital markets and a South African rand denominated loan from its parent company. The company's stated intention is to repay the shareholder loan in order to remove currency volatility from its earnings line and it has been successful in reducing the outstanding loan amount over the past six months. Real People maintain a healthy liquidity position given the positive liquidity gap between its assets and liabilities.

5.2. Liquidity Management

Short-term liquidity Policy

Real People vigilantly manages liquidity risk through strict adherence to its liquidity policy. The short-term liquidity policy was developed from the principles of Basel II's Liquidity Coverage Ratio and is designed to ensure that the company is able to meet all of its short-term obligations during any 12 month rolling period as described:

Net cash position over the forthcoming 12 months is calculated as follows:

- Expected receipting less 10% haircut, less
- Committed operating expenses, less
- All contractual interest and capital repayments

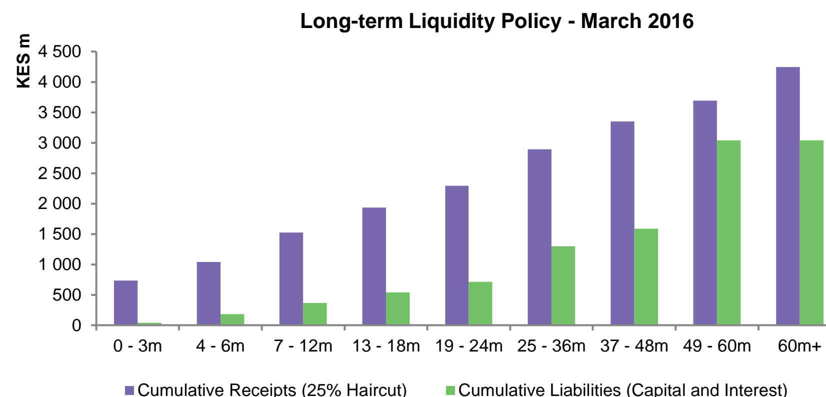
Unencumbered cash together with unutilised committed credit facilities are required to cover any shortfall and, as at 31 March 2016, comfortably meets this requirement as can be seen in the table below.

KES'm	Sept-15	Dec-15	Mar-16
Receipting (10% haircut)	1,919	2,075	1,330
Committed expenses	(624)	(642)	(593)
Liability payments	(598)	(480)	(364)
Total net cash inflow	**696**	**953**	**374**
Available cash and facilities	972	498	381
Surplus	**1 669**	**1 451**	**755**

Long-term liquidity Policy

In the long term, the business safeguards its debt obligations by ensuring that at any point on its funding profile the following limits are strictly adhered to:

- *Cumulative mismatch limit:* 75% of expected cumulative receipting must at any point on the funding profile exceed the cumulative cash outflows related to contractual debt payments (capital and interest). This is measured and monitored on a monthly basis.



6. Business Prospects

The competitive environment in the market is expected to tighten further, but management is of the view that the market opportunity in our selected microenterprise and SME segment remains significant.

In the first half of FY2017 (April – September 2016), Management will take a conservative approach to asset growth as we consolidate our efforts in further strengthening the collections expertise, conduct a product re-price exercise and implement a new business intelligence platform.

We therefore intend to focus on steady marginal growth with a keen eye on asset quality through the strengthening of our underwriting and collections processes and systems. The ongoing collections revamp project will enhance our collections systems, processes and capabilities. At the same time, the business intelligence platform being developed for deployment in the course of 2016 will ensure more robust analytics and reporting in the business. With this approach, management expects a consistent enhancement of asset quality and steady growth in the book, in line with our responsible growth agenda.

While the General Purpose Facility (GPF) will remain our flagship product, we are in the process of conducting a product review on the Productive Asset Loan (PAL) to ensure it remains competitive and attractive to our customers. We intend to relaunch the product in September 2016.

As part of the management of the operational expenditure, we envisage a cost rationalisation exercise to ensure that the business continues to run as lean as possible but without compromising long term viability. We continue to ensure that staff capacity is built as required by the business and that the necessary skills are retained in the business. In addition, the emphasis on people will continue to enable us to marshal the required expertise to deliver on our strategic choices aligned to our operating model in accordance with our targeted market segment whilst focusing on product differentiation and the customer value proposition.

7. Financial Results

7.1.1. Income Statement

Statement of financial performance

	H1 Sep 2016 Kes 'm	H2 Mar 2016 Kes'm	FY Mar 2016 Kes 'm	FY Mar 2015 Kes 'm	2016 V 2015
	Act	**Act**	**Audited**	**Audited**	**Var**
Gross yield from assets	494	639	1133	961	18%
Impairment provision	(89)	(236)	(325)	(214)	52%
Net yield	**405**	**403**	**808**	**748**	**8%**
Finance costs	(118)	(183)	(301)	(214)	40%
Net margin	**287**	**220**	**507**	**534**	**-5%**
Operating expenditure	(238)	(285)	(523)	(403)	30%
Profit Before Except Items	**49**	**(65)**	**(16)**	**131**	**<100%**
FX income	16	54	70	81	-14%
Non-recurring adjustments		(185)	(185)		-
Profit Before Tax	**65**	**(197)**	**(131)**	**212**	**<100%**

Gross yield

The growth in gross yield of 18% year-on-year correspond to the balance sheet growth as loan origination volumes increased during the year, made possible following the bond issue in August 2015.

Impairments

Impairment charges:

- The change in estimate used under the provisioning methodology is based on data analysis over an extended period of 3 years with the intention of moving towards IFRS 9 compliance, which comes into effect in 2018. The new estimate is more forward looking where provisions are taken in advance based on projected roll rates and expected recovery rates. This method also ensures that contracts with no activity over a period of 12 months are forced into NPL status. The change in estimate has resulted in an additional ***KES 185 Million*** impairment out of the total provisions charged for the year.
- The interest rate spike period from August 2015 affected the ability of some of our clients to service their debts as banks abruptly raised their lending rates (our customers are multi-borrowed). This led to a rise in rolls from performing loans into NPLs and hence more provisions.
- The suspension in PAL lending and discontinuation in MEF lending has led to the spike in impairments for those products although both products are now adequately provided for. Please note that PAL and MEF product are discontinued.

Impairment Analysis per Product	2015 Ksh'M	2016 Ksh'M
GPL	141	99
PAL	59	115
Others (MEF, Housing, Group Lending)	13	111
Total	**214**	**325**

Coverage per Product	Mar-16
GPF	93%
PAL	97%
Others	95%
Total	**95%**

Finance costs

Finance costs increased by 40% year-on-year in line with the increase in year-on-year funding liabilities following the August bond issue. However, the company's effective cost of funding has decreased to 15.0%% from 20.0%.

Operating costs

The 30% growth in operating costs is primarily attributable to:

- Increased staff costs arising largely from the introduction of a pension scheme for staff in FY2016 and to a lesser extent an increase in the staff count and inflation adjusted annual increases. Staff training costs also increased, adding to the general increase in employee related costs.
- Amortisation of costs related to upgraded origination and credit assessment technology (Project Victoria),
- Premises costs due to relocation of branch offices in Nairobi and Nakuru, and
- Targeted marketing activations and company secretarial costs relating to deregistration of dormant companies.

Key Performance Indicators

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Return on interest bearing assets	34.0%	30.9%	31.1%	32.9%	33.3%
Cost of funds	20.0%	14.0%	14.6%	15.5%	15.0%
Credit loss ratio	9.4%	9.0%	7.0%	10.3%	16.4%
Credit loss ratio (normalised)	***9.4%***	***9.0%***	***7.0%***	***10.3%***	***10.5%***
Fees over interest bearing assets	4.5%	8.5%	6.9%	6.6%	7.0%
Net NPL ratio	0.5%	6.9%	5.2%	5.0%	4.6%
Gross NPL ratio	19.6%	29.7%	25.5%	24.8%	34.9%
Provision coverage	***130%***	***88%***	***94%***	***94%***	***95%***

7.1.2. Balance Sheet

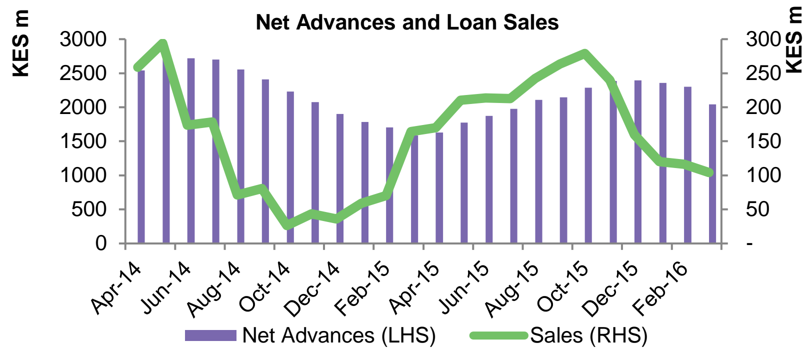
Statement of financial position

	Sep 2016 Kes 'm	Mar 2016 Kes 'm	Mar 2015 Kes 'm	2016 V 2015
	Act	**Audited**	**Audited**	**Var**
Assets				
Cash and cash equivalents	980	383	230	67%
Loans & Advances (Net)	2,148	2,085	1,697	23%
Property & Equipment	135	148	113	31%
Other assets	202	311	86	>100%
Total Assets	**3,465**	**2,927**	**2,125**	38%
Liabilities & Capital				
Borrowed Funds	2,435	2,004	1,069	87%
Other liabilities	9	26	65	-60%
Equity	1,021	898	991	-9%
Total Equity & Liabilities	**3,465**	**2,927**	**2,125**	38%

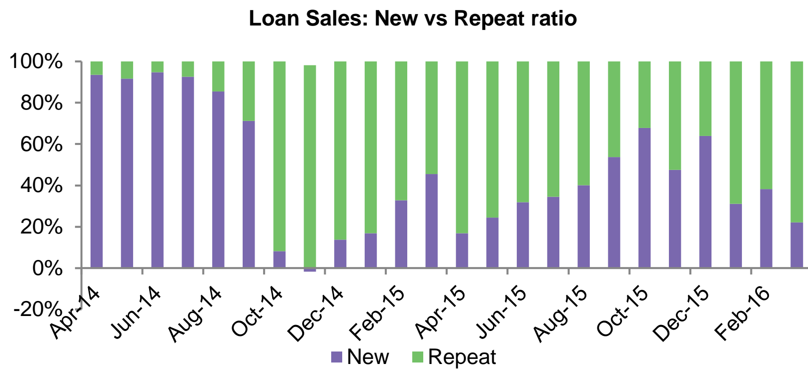
Cash includes a KES 150 Million call deposit with Rafiki MFB at 13% with a monthly withdrawal plan over six months. The first 3 payments have been honoured (40 % of the total exposure) and we expect the remainder of the contractual obligations to be honoured as agreed.

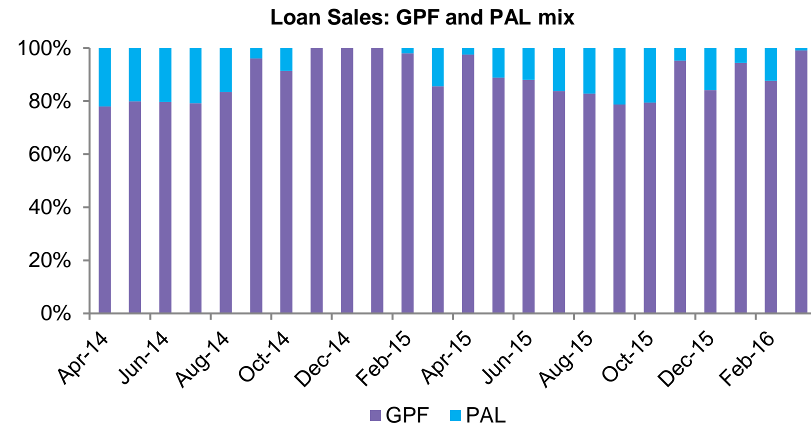
Asset Origination

Asset origination picked up in August 2015 following the bond issue. However, shortly after, the adverse change in the interest rate regime led to a sharp reduction in credit demand. Furthermore, we deliberately slowed originations of our PAL product as we seek to improve its structural features. This product remains under reconstruction to date and is expected to re-launch later this year. The suspension of this product has further contributed to the current declining trend in loan sales.



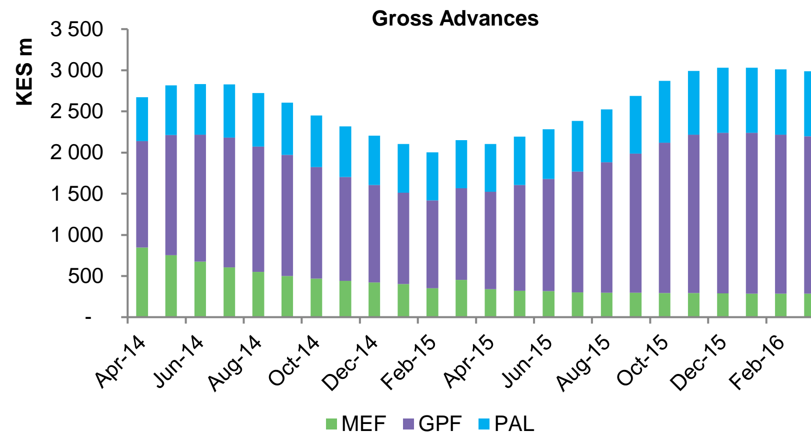
We have continued to prefer repeat business to new customer originations as we enhance our collections and underwriting procedures and thus repeat business on the GPF product dominates in the recent past.





Gross Advances – Total Portfolio

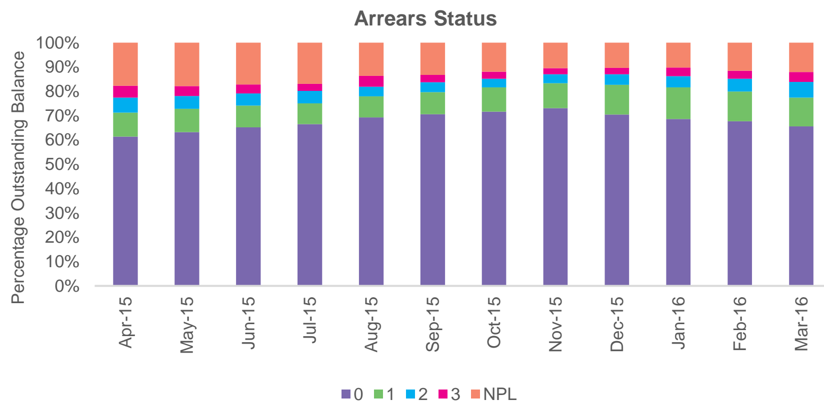
Total advances stabilised at KES3 billion mark, exceeding the high of KES2.8bn achieved in previous periods.



8. Credit Quality

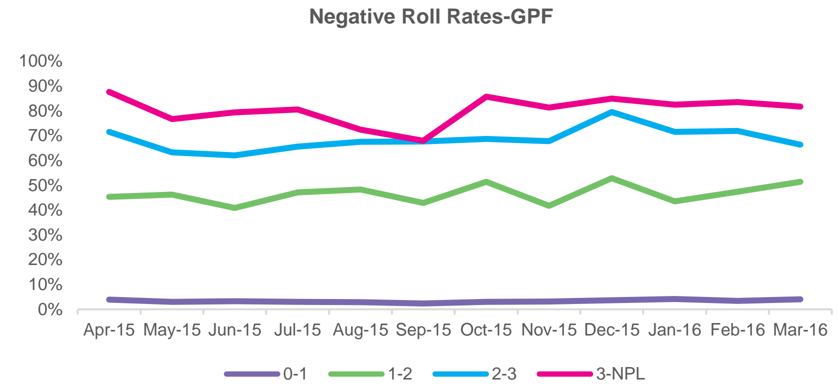
The performance of the loan book during the second half of the financial year has been below expectations (especially the below par performance on the PAL book), as reflected in the graphs below. However, we have taken the necessary corrective measures and the more recent (last 6 months) underwritten loans performed much better than the older vintages.

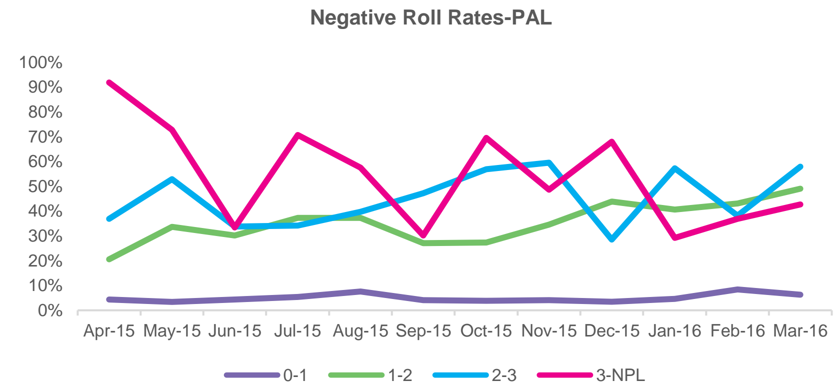
Arrears Mix (Gross)



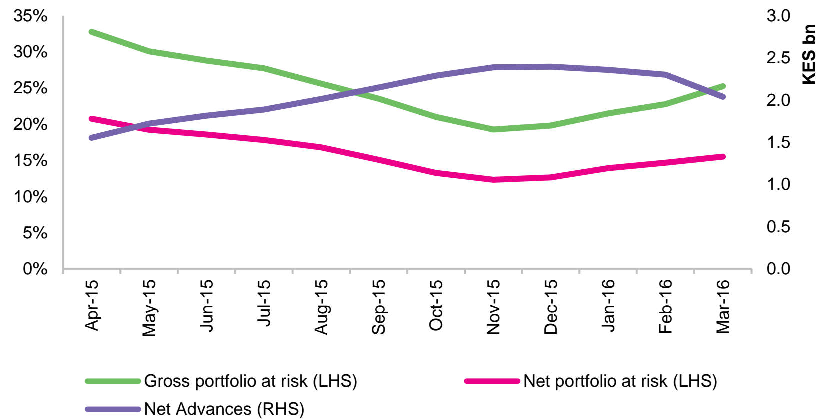
The arrears mix showed signs of stress in the last quarter mainly from the PAL product on the back of the earlier vintages written. This situation is expected to reverse from re-launch with strengthened collections and underwriting.

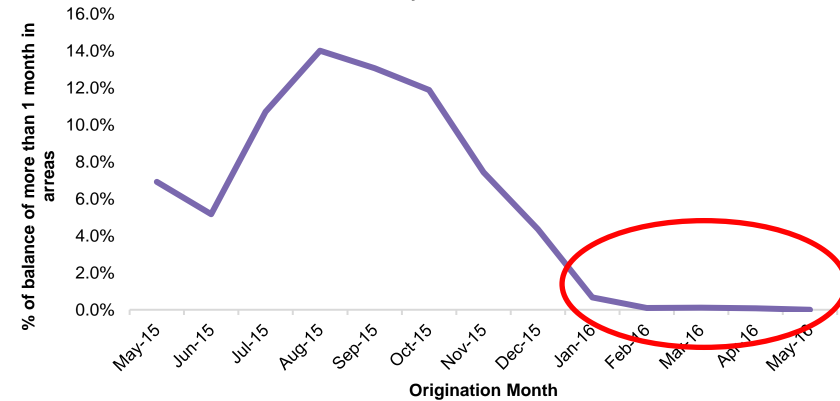
Roll Rates





P@R 30



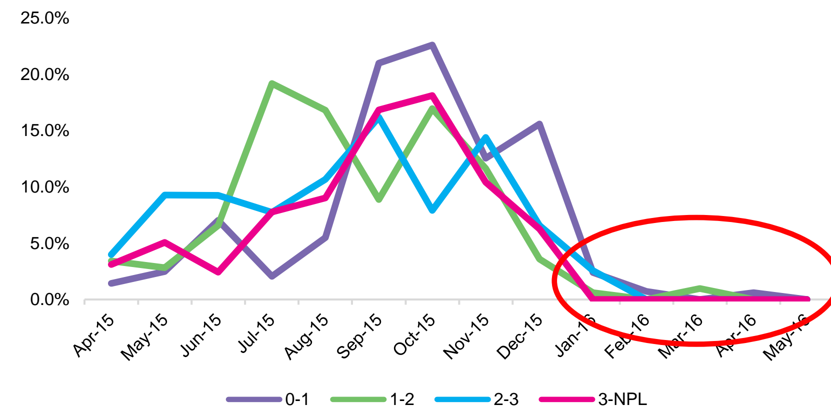


Implementation of Additional Credit Vetting Mitigants

During December 2015, we reviewed our credit process and made the following improvements:

1. Introduction of additional loan appraisal procedure (branch approval committee) in addition to central vetting
2. Extensive customer call-backs during the vetting process, in addition to Referee Call
3. Mandatory client visits by the branch leadership team (in addition to the relationship officer) before the loans are sent for processing by the vetting team.

Following the implementation of the improvements, we have seen significant improvement in the quality of vintages originated as illustrated in the graphs below:



The graphs below shows the current P@R 30 and Negative roll rate analysis per origination vintages as at June 2016. Although still early days, the vintages since the credit revamp have shown a material improvement.